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UNCLAS SECTION 01 OF 02 TAIPEI 003444

SIPDIS

STATE PLEASE PASS AIT/W AND USTR

STATE FOR EAP/RSP/TC, EAP/EP AND EB/IFD/OIA

USTR FOR SCOTT KI

USDOC FOR 4420/USFCS/OCEA/EAP/LDROKER
USDOC FOR 3132/USFCS/OIO/EAP/ADAVENPORT
TREASURY FOR OASIA/ZELIKOW AND WISNER
TREASURY PLEASE PASS TO OCC/AMCMAHON
TREASURY ALSO PASS TO FEDERAL RESERVE/BOARD OF
GOVERNORS, AND SAN FRANCISCO FRB/TERESA CURRAN

E.O. 12958: N/A

TAGS: [EINV](#) [EFIN](#) [ECON](#) [TW](#)

SUBJECT: Problem Bank for Sale

1. Summary. Taiwan authorities will auction off another problem bank currently in receivership at the beginning of December, part of their on-going effort to reduce the number of banks and thereby improve the health of Taiwan's financial sector. However, creditor banks will not receive payment until the legislature provides additional funding for the financial reconstruction fund charged with addressing problem banking institutions. Taiwan has 11 other banks and dozens of small community financial institutions with relatively high non-performing loan ratios that have not yet been addressed. End Summary.

Bidding Schedule, Qualifications

2. Taiwan's Central Deposit Insurance Corporation. (CDIC) will conduct open bidding on December 9 for the Chung Shing Bank (CSB), the last problem financial institution still under CDIC receivership (CDIC has not yet addressed the 11 other problem banks). A CDIC official told AIT that qualifications for bidding have been relaxed to permit both domestic and foreign securities firms, insurance companies, and investment institutions. (In the past, only local and foreign financial holding companies and banks were permitted to bid for problem banking institutions.) Interested companies are required to register before November 4. CDIC also requires that the winning bidder must raise CSB's capital from the current NTD 5 billion to above NTD 10 billion within three years. If a bank wins the bid, the bank must still meet the 8 percent capital adequacy ratio after acquiring CSB.

Good and Bad Parts of the Bank Separated

3. Although the CDIC sold most of CSB's non-performing loans in December 2003 and March 2004, the December sale will also exclude some of CSB's remaining liabilities. The excluded liabilities are time deposits, deposits of other banks, negotiable certificates of deposit issued by CSB, and liabilities obtained from the inter-bank market. CDIC has obtained the creditor banks' assent to delay repayment of the NT\$64.9 billion owed to them until the Legislative Yuan passes a bill to increase the funding for the Financial Reconstruction Fund (FRF, similar to the U.S. RTC.) According to an official at CDIC's Banking Institution Disposal Department, if the additional funding bill fails to pass before the FRF expires on July 9, 2005, the Treasury will pay the CSB's outstanding liabilities. CSB will not be required to pay this amount. FRF funding has come from a 2-percent gross business receipt tax collected from financial institutions. The CDIC sale in December will be the remaining, relatively healthy, parts of the bank with a positive net worth of NTD 6.4 billion. There will be no need for any additional compensation to the winning bidder from FRF, as was needed in the two other sales of problem banks this year.

4. CDIC has received inquiries about the sale from several foreign firms and seven local financial institutions (including Cathay United Bank and ChinaTrust Commercial Bank). Late last year, Taiwan's Bureau of Monetary Affairs stopped issuing permits for new bank branches in an effort to address the problem of too many banks for the size of the market. (Taiwan has more than double the number of bank branches per capita of other Asian markets.) This leaves merger or acquisition as the only way to expand bank networks. The winner of the bid for CSB will take over its 34 branches and will be allowed to open another 12 branches. The bid winner will also be authorized to transform the CSB trust department into a branch office and to relocate offices as desired.

Two Earlier Sales of Problem Banks

15. The use of the financial reconstruction fund to repair the banks books and the chance to acquire additional bank branches proved attractive to other domestic banks. In late May the CDIC sale of the Kaohsiung Business Bank (KBB) attracted bids from eight local financial institutions. The winner was the E. Sun Bank, which wanted to expand its presence in southern Taiwan. In exchange for acquiring the KBB's 60 banking offices, E. Sun paid NTD 3.73 billion. This amount was the gap between the FRF's compensation of NTD 13.37 billion and the KBB's net worth of negative NTD 17.1 billion. In July, the sale of the problem Fifth Credit Cooperative Association of Fengshan (FCCAF) also attracted eight bids. The winner was the ChinaTrust Commercial Bank, which, in exchange for the FCCAF's 10 banking offices, paid NTD 760 million, the gap between FRF's compensation of NTD 1.1 billion and the FCCAF's net worth of negative NTD 1.86 billion.

Serious Problems Remain

16. The resolution of CSB will totally exhaust the FRF funding of NTD 140 billion. If Taiwan's legislature fails to increase the funding, there will be no ready solution for the other 11 problem banks and 93 problem credit departments of farmers' associations. Financial officials estimate that NTD 270-280 billion will be required to address these problem institutions. Taiwan officials have said they welcome foreign ownership of a local bank to heighten competition in the banking sector. However, while foreign investors are allowed to bid for CSB, the restriction on opening new branches encourages local banks to consider acquiring CSB in order to expand their business. This pressure may increase the amount that domestic banks are willing to pay for CSB.

PAAL